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Review

Property @ction

We are delighted to introduce you to this new quarterly review prepared by the Hammonds' property litigation team, known as Property @ction.

This review focuses on recent developments and topical areas relevant to landlords, tenants, surveyors and others involved in property.

In this edition we look at:

(i) Whether the costs of entertainment and promotional activities can be passed back to the tenant, through service charge provisions in leases

(ii) Best endeavours and reasonable endeavours; what the obligations really mean

(iii) Whether a landlord can carry out intrusive inspections and investigations to establish the extent of any disrepair

(iv) The need for caution to avoid an inadvertent surrender of a lease

(v) The Mercury Tax case and the lessons to be learnt regarding the execution of documents

(vi) Without Prejudice and the impact of such a label on rent review notices

All feedback and comments are appreciated. Also, if there are any topics you would like covered in future editions, please contact a member of the team.

Let me entertain you…?

With consumer spending down, landlords of shopping centres are putting more energy into, and investing more money in promotional activities to encourage shoppers to their centres. Steps taken by landlords may include displaying festive decorations, advertising on local radio stations and providing entertainments in the centre itself. This is all designed to attract new customers and to encourage existing customers to stay longer and ultimately spend more money.

With tenants feeling the pinch, extra care needs to be taken to ensure that the service charge provisions are drafted in such a way that any promotional costs incurred by the landlord can be passed back to the tenant. If not, the landlord will end up out of pocket and bearing the costs.

The Facts

In *Boots UK Limited v Trafford Centre Limited*,[1] a dispute arose in Manchester's Trafford Centre. The lease granted Boots a term in a retail unit and provided specifically for Boots to pay to the landlord a service charge. It also stated that the landlord would bear half the cost of "promotion" in any service charge period. That term was defined in the lease as *"advertising and other forms of promotion of the centre intended to bring additional custom to the centre"*.

The landlord provided four things which Boots, but not the landlord, considered to be promotion: Christmas decorations, entertainments such as the provision of jazz bands, a Santa's Grotto and a large television screen displaying information about the centre and advertising from retailers at the centre and external organisations. If Boots was right in its interpretation, that the items in question were promotion costs and it would have been entitled to a refund of several hundred thousand pounds from the landlord.

Boots submitted that those items were intended to bring additional custom to the centre, and asserted that they were, therefore, a form of promotion. The landlord argued that a promotion could occur only where the advertising or promotion was outside the centre, and it had to be something unusual and irregular as to occurrence.

The decision

The Court said that there was no hard and fast rule regarding the meaning of "*promotion*". An external location, unusualness and irregularity were features that would often be found in promotion, but those features were not essential in all cases. The main test was whether the acts promoted the centre or whether they were simply for the benefit of the centre. A Santa's Grotto, for example, is likely to be for the benefit of a centre rather than promoting it. The large television screen, however, displaying information about the centre and advertising from retailers at the centre and external organisations, was likely to be a promotion.

The wording of the lease is key and any landlord should examine very carefully the service charge provisions before spending significant sums promoting the centre, or indeed on arranging entertainments in the centre. Tenants, as shown by the Boots case, are clearly willing to challenge service charge claims and it may be that any entertainments arranged by the landlord will be at its own cost.

1 *Boots UK LTD v Trafford Centre LTD [2008] EWHC 3372 (Ch)*

Sweeper Clauses

Many leases, particularly older ones, may be silent regarding promotional activities. Landlords are trying to pass promotion and entertainment costs back to the tenants through general sweeper clauses in leases.

The wording of such a clause is along the lines of *"the landlord may recover through the service charge provisions the cost of any other services which the landlord in its reasonable discretion shall provide for the benefit of the centre"*. Whilst again there is no hard and fast rule regarding this, and each case will turn on its own specific wording, our experience is that Courts can be reluctant to allow landlords to recover promotional and entertainment charges under such clauses.

Reasonable or best endeavours – what's in a word?

Most people are familiar with, and will have seen, whether in leases or other commercial contracts, the requirement on a party to use best endeavours or reasonable endeavours to perform a particular obligation.

There is perhaps an assumption that they mean the same thing, and that it's just a particular lawyer's choice of words, but this is wrong. They do mean very different things and advice should always be taken.

Best Endeavours

This is a high threshold with a heavy burden and it should not be agreed to, if possible. To comply with the obligation you must leave *"no stone unturned"*, as a case from 1911 put it, in trying to comply with the obligations contained in the agreement. You have to take all steps that are capable of being taken to produce the desired results. These are steps that a prudent, determined and reasonable person acting in his own interest would take.

Whether there has been compliance will be a question of fact. Typically, however, the Courts would expect to see the party under the obligation expending time and money to secure compliance (if so necessary in order to achieve a goal), and potentially in considerable amounts. There is no need to go as far spending so much that the financial stability of a company is threatened but something substantial is required.

Reasonable Endeavours

This is a less onerous obligation. There may be a number of reasonable courses which could be taken in a given situation to achieve a result. An obligation to use reasonable endeavours only requires the party to take one reasonable course.

Contrast this with best endeavours which requires a party to take all reasonable courses he can. A company will still be expected to incur some expense and time in seeking to comply with its obligation but it will not have to go so far that it financially and commercially disadvantages the party.

Comment

There is a significant difference between the obligations imposed by a reasonable endeavours clause and a best endeavours clause. When contractual terms are being negotiated, care is needed as to the final words that are used. At a time when parties are looking at ways of claiming damages, or even getting out of contracts, it is important to know what you have signed up for and that it is achievable.

Actions may often be louder than words

Whether a landlord has accepted a surrender of a lease will depend more on the landlord's actions rather than its intentions or what it says.

The Facts

In *Artworld Financial Corporation v Safaryan*[2], a substantial house in Holland Park was let to the Safaryan family at a rent of £390,000 per year. The family was unhappy with the house and left in 2006, midway through their lease. The Safaryans said that the central heating and swimming pool did not work properly and, notwithstanding their complaints, the problems were not fixed by Artworld, as they should have been under the lease.

The Safaryans returned the keys and the landlord claimed payment of rent for the outstanding period of the lease. The Safaryans said that, notwithstanding the position being put forward by Artworld's solicitor that the lease was continuing, Artworld's conduct showed otherwise. The Safaryans argued that Artworld had accepted a surrender of the lease as the property was redecorated, works were carried out and members of the landlord's family were living there.

The Decision

The judge found that, notwithstanding the position put forward in solicitor's correspondence that the lease was ongoing, the conduct of the landlord was such as to accept a surrender of the lease.

The landlord, when the Safaryans moved out, began to occupy the property for its own benefit. Keys had been accepted, repairs were carried out and more importantly, members of the family, which owned the landlord company, began living there.

Care is always needed when keys are accepted. Just because correspondence puts forward the position that there has been no surrender, it is the conduct of the landlord that will be important.

Comment

Queries are often raised as to whether a landlord can take steps to secure or preserve the property. Also, we are often asked whether steps can be taken to market the premises without accepting a surrender. Self-help remedies, to protect and preserve the property, will usually not amount to a surrender as they are preserving the landlord's property and will be seen as a reasonable response to the failure, by the tenant, to perform its obligations under the lease. Equally, the landlord taking steps to keep the garden tidy, for example, is not necessarily inconsistent with an ongoing landlord and tenant relationship. Furthermore, the landlord's seeking to re-let the premises will not necessarily give rise to a surrender by operation of law, as it is no more than what the landlord might reasonably be expected to do in the circumstances for the potential benefit of all parties. The landlord must be entitled to seek to mitigate the damage caused by the tenants abandoning the lease, by seeking to obtain another tenant.

However, if the landlord goes further and uses the premises for his own benefit beyond the totally trivial then, as the Court of Appeal found, it re-takes possession of the premises inconsistently with the continuance of the lease. This will give rise to a surrender.

If in doubt, advice should be taken regarding whether conduct amounts to a surrender of the lease. In the current climate, and particularly with exposure to the rates liability for empty units, caution is required.

2 *Artworld Financial Corporation v Safaryan & Others [2009} EWCA Civ 303*

Do you mind if I bore you?!

Leases nearly always give the landlord the right to enter the demised premises to inspect the condition of the premises and its state of repair. However, two recent cases, both involving Kwik Fit, have examined how far a landlord can go in carrying out investigations. In particular, the cases examine whether a landlord can carry out intrusive investigations to establish the extent, if any, of breaches under the lease.

The Facts

As mentioned above, the two cases both involved Kwik Fit although one case was heard in Scotland and one was heard in England. The English case is *Heronslea (Mill Hill) Limited v Kwik Fit Properties*.[3]

The property was an old petrol station and the landlord was concerned that fuel may have leaked into the sub-soil. It therefore wished to carry out an "environmental investigation survey", pursuant to a clause in the lease that gave it the right to enter the premises for the purpose of making a survey, and to inspect the premises. It wanted to drill 13 boreholes to a depth of five metres below ground and one to a depth of 20 metres, and obtain samples for geo-environmental assessments. Kwik Fit refused on the basis that the lease did not allow for such intrusive investigations and that it would disrupt its business.

The Decision

The Court found that the lease did not entitle the landlord to enter the property, drill boreholes and take samples. The relevant question was whether the lease, on its proper interpretation, permitted the landlord to enter the premises to drill boreholes and take samples. It was clear that a reasonable person, having all the background knowledge that would reasonably have been available to the parties at the time the lease was executed, would not have thought so.

Comment

The decision turns on the meaning of the word *"survey"*. A reasonable person would not interpret it as meaning to carry out such disruptive surveys as envisaged by the landlord. There could potentially be a different outcome if the clause in the lease said *"investigations"* rather than *"survey"*. However, digging holes requires more than just a right to enter and inspect. Furthermore, the fact that there was only a suspected breach of covenant was another reason why the landlord could not proceed.

Clarity in a lease is paramount. The tenant's right to quiet enjoyment is something that the Courts strive to protect. The moral of the Heronslea story is that such issues need to be addressed at the time the lease is drafted. If it is likely that entry on to the land may be required to carry out detailed surveys and/or investigations, then that right needs to be reserved when the lease is executed.

Would a similar outcome take place if say the landlord wanted to investigate the air conditioning system or some other mechanical and electrical system? A landlord may only be able to carry out such investigations by removing casings from equipment and this could be intrusive and disruptive. Again, if there is a suspected breach then perhaps the landlord will be unable to proceed. However, if there is an actual breach, say because the air con system is not working, then it may be permissible if the notice served identifies the breach and says that remedial works, to include removing covers and casings, are necessary. Much will, however, depend on the wording in the lease.

3 *Heronslea (Mill Hill) Limited v Kwik Fit Properties Ltd [2009] EWHC 295 (QB)*

Signed, sealed and delivered … but is it yours?

Such is the rush to complete commercial deals that the parties often look for short cuts that can be taken. Signatories may not be available at the time completion is due to take place. Also, it may be that some post-execution amendments need to be made.

The Mercury Tax Group Case[4] is an important decision regarding the execution of documents. It provides that formalities must be observed notwithstanding commercial desires and the wish to complete as quickly as possible. The Court was concerned with the practice of taking a signature page from one document, and recycling it for use in another, notwithstanding the fact that in modern commercial times it is not always practical for multi-party contracts, deeds and other instruments to be signed in the same place at the same time.

The case involved the execution of signature pages whilst the deed in question was still in draft. Mercury argued that this was common practice in line with *"modern commercial times".* The problem was that after execution, and without notifying the signatories, some significant changes were made to the deed and blanks in the document were filled in. The Court found that the deed was not validly executed as *"the signature and attestation pages must form part of the same physical document".*

Whilst speed is always an imperative when deals are being done, the failure to execute documents in a proper way will mean that the document could be invalid.

The key point to take away from this case is that the parties should avoid signing pages that do not form part of the finalised document. If one of the signatories will not be around, when completion is scheduled to take place, then consideration should be given to arranging for a Power of Attorney to be put in place.

The judge, in Mercury, took the view that a deed has to be executed by an individual in its final version and said that validity of a document will be effected by the practice of signature pages being detached from an incomplete draft and attached to a later, and significantly different, version. Arguably, a similar position would apply to real estate contracts due to the formalities, laid down by statute, that need to be followed with their execution.

However, the decision is not of the Court of Appeal and it remains to be seen how wide its implications are or whether it is limited to its own facts. Until further guidance is obtained, it is advisable to be very careful with the execution of documents, particularly deeds and real estate contracts. If there is any doubt, legal advice should be taken at the time contracts are signed.

4 *R (0n the application of) (1) Mercury Tax Group Ltd & Others v (1) Revenue & Customs Commissioner & Others [2008] EWHC 2721 (Admin)*

Without prejudice and rent review notices

There is much that can go wrong with rent reviews but it may be thought that the easiest part of the process is starting it.

Quite often, rent reviews are triggered by notification by the landlord in writing specifying a proposed rent. If the tenant does not respond, or seeks to refer matters to a third party for determination, then it will be stuck with that rent. However, if the trigger notice is headed *"without prejudice"* or *"subject to contract"* then what effect does this have? It is a common problem for lawyers that these labels are used too frequently, and on important pieces of correspondence that you want to be very much "with prejudice", or capable of being subsequently relied upon.

The Facts

In *Maurice Investments Limited v Lincoln Insurance Services*[5] the trigger notice served started by saying that the landlord wanted to *"start the rent review procedure for June 2004"*. It went on to say that the landlord wanted to "avoid the usual protracted negotiations… and would like to quote a rental at £360,000 per annum exclusive with effect from June 2004". The letter was headed both *"without prejudice"* and *"subject to contract"*.

The tenant received the letter, wrote to acknowledge it and was clearly in no doubt that the rent review process had been started. The parties did not agree the rent, the tenant did not elect to refer the matter to a third party, as required by the lease, and the landlord then claimed the rent would be as set in the trigger notice. The tenant resisted this and claimed that the heading to the notice, *"without prejudice and subject to contract"* meant that the notice had no legal effect whatsoever.

The decision

The judge found in favour of the tenant and said that whilst a reasonable recipient of the notice would think that the landlord was initiating the rent review, it was also possible for reasonable recipient to think that the landlord was putting forward an offer to reach a quick agreement and was not bringing into operation the formalities under the lease.

Comment

There has to be some doubt whether this case is good law and will be followed by the Courts. The landlord did appeal but the claim settled before it was dealt with by the Court of Appeal. The point to note, however, is that thought is needed regarding the application of the *"without prejudice"* and *"subject to contract"* labels. As with the landlord in the Maurice Investments case, putting such labels on correspondence unnecessarily could prove very harmful indeed as it could lead to the documents having no legal effect.

5 *Maurice Investments Ltd v Lincoln Insurance Services Ltd [2007] 1P&CR 14*

FURTHER INFORMATION

For further information please contact:

Patrick Walker
Director for Advocacy
T: +44 (0)113 284 7566
E: patrick.walker@hammonds.com

Sally Lodge
Partner
T: +44 (0)113 284 7102
E: sally.lodge@hammonds.com

William Lawrence
Partner
T: +44 (0)20 7655 1551
E: william.lawrence@hammonds.com

Joe Copping
Associate
T: +44 (0)20 7655 1578
E: joe.copping@hammonds.com

Caroline Wort
Senior Associate
T: +44 (0)121 222 3405
E: caroline.wort@hammonds.com

Helen Hoath
Senior Associate
T: +44 (0)161 830 5068
E: helen.hoath@hammonds.com

Hammonds

Berlin

Hammonds LLP
Unter den Linden 14
10117 Berlin Germany
Telephone +49 30 7261 68 000
Fax +49 30 7261 68 001

Birmingham

Hammonds LLP
Rutland House
148 Edmund Street
Birmingham B3 2JR
Telephone +44 (0)121 222 3000
Fax +44 (0)121 222 3001

Brussels

Hammonds LLP
Avenue Louise 250
Box 65
1050 Brussels Belgium
Telephone +32 2 627 7676
Fax +32 2 627 7686

Leeds

Hammonds LLP
2 Park Lane
Leeds LS3 1ES
Telephone +44 (0)113 284 7000
Fax +44 (0)113 284 7001

London

Hammonds LLP
7 Devonshire Square
London EC2M 4YH
Telephone +44 (0)20 7655 1000
Fax +44 (0)20 7655 1001

Madrid

Hammonds LLP
Plaza Marques de Salamanca 3-4
28006 Madrid Spain
Telephone +34 91 426 4840
Fax +34 91 435 9815

Manchester

Hammonds LLP
Trinity Court
16 John Dalton Street
Manchester M60 8HS
Telephone +44 (0)161 830 5000
Fax +44 (0)161 830 5001

Munich

Hammonds LLP
Karl-Scharnagl-Ring 7
80539 Munich Germany
Telephone +49 89 207 02 8300
Fax +49 89 207 02 8301

3025/07/09

Paris•

Hammonds Hausmann
4 Avenue Velasquez
75008 Paris France
Telephone +33 1 53 83 74 00
Fax +33 1 53 83 74 01

Hong Kong•

Hammonds
Suites 3201-05, 3217-20
32nd Floor Jardine House
1 Connaught Place
Central Hong Kong
Telephone +852 2523 1819
Fax +852 2868 0069

Beijing+

Hammonds Beijing
Representative Office Hong Kong
Suite 1419 - 20
South Tower Beijing Kerry Centre
1 Guang Hua Road
Chao Yang District
Beijing 100020 China
Telephone +86 108529 6330
Fax +86 10 85296116

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